RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $185 Annually
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February 24, 1982 **LETTER 829**

Feb. 12, DJIA 833.81; PTI 1356; A-D ratio –25.71
Feb. 19, DJIA 824.30; PTI 1346; A-D ratio –26.10

THE MARKET: As of February 19 the advance-decline line on the NYSE was down 10 out of 11 weeks! You don't see many strings like that (it has only happened four times in the last 20 years), and on a "return to equilibrium" basis one would think that some kind of rallying action (even an anemic rally) would be in order. True, when the market declines in 10 out of 11 weeks it must be discounting something ominous going on "out there." And we could spend the rest of this Letter speculating on whether "the thing" is deflation, a business crisis, political paralysis or what have you.

Technically, the remarkable part of the picture is that with the A-D ratio for the NYSE breaking back to 1976 (that's right, 1976) levels, the D-J Averages have nevertheless refused to violate their September lows. A violation of the September lows would entail the Industrials breaking the 824.01 level (see chart) with Transports confirming by cracking their own 335.48 low. That may happen in a few days or weeks, but it has not happened yet. Until it does, the stage is set for some kind of corrective rally. Meanwhile, this complex and confusing bear market continues–in its own way and in its own good time.

Much is being made (by the bulls) of the fact that half the stocks on the NYSE are currently selling below book value. "They're cheap," claim the bulls, "and cheap stocks resist decline." Maybe so, but bears retort that bonds are even cheaper, and stocks won't go up until bonds stop going down. Secondly, some ancient souls remember that stocks looked ridiculously cheap back in 1931–just before the Dow cut itself in half on its way to a final low of 41.22 recorded in July, 1932.

Personally, I prefer not to get involved in the "cheap" or "not cheap" argument: instead, I watch the market for clues as to the trend. Below is a second installment of my market diary (continued from the last Letter):

Feb. 8...NYSE Composite hits a new 1982 low of 66.32.
Feb. 8...S&P 500 hits a new 1982 low of 114.63.
Feb. 8...Negative volume index hits a new bear market low.
Feb. 17...A-D ratio for the NYSE hits a new low of minus 25.96, thereby breaking below the Jan. 26, 1982 low and the Sept. 25, 1981 low–to the lowest level since 1976.

Feb. 17...PTI sinks to 1346, lowest level since Nov. 11, 1980.
Feb. 17...Dow A-D drops to a new bear market low of 68.
Feb. 17...Most active stock index (cumulative) breaks to a new 1982 low.

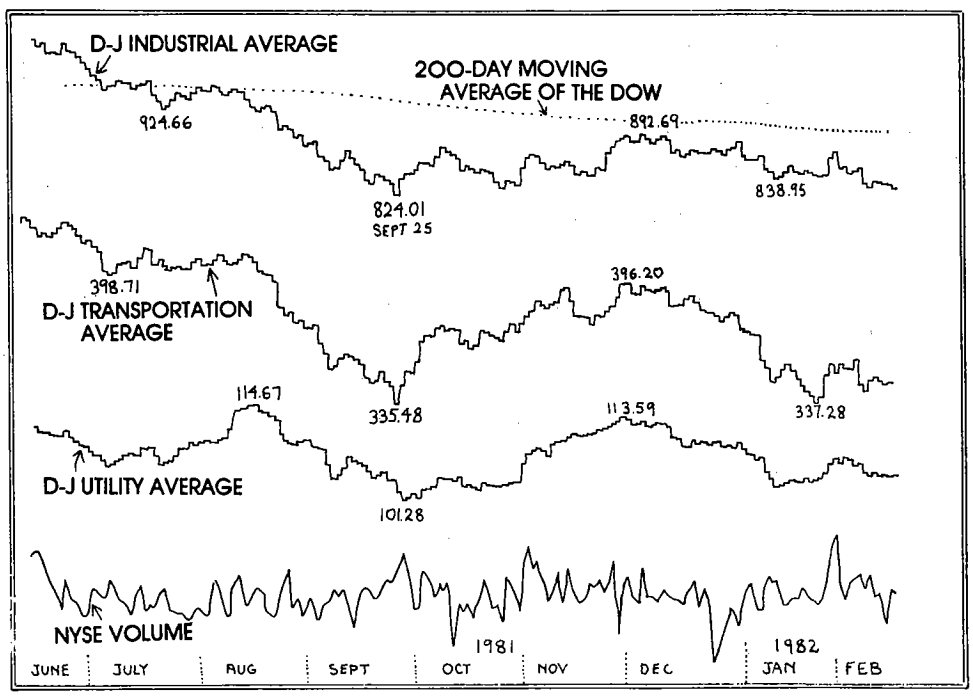
I continue (as I have for weeks) to place great emphasis on the September lows for the D-J Averages. Utmost importance should be placed on the ability (or inability) of the Averages to hold above those September lows. A plunge by both Averages under the lows would be very bearish for the market (as well as being an ominous forecast for the economy). Conversely, a persistent refusal by one or both Averages to penetrate the September lows–will be a sign that the market wants to correct the downside excesses of the past three months.

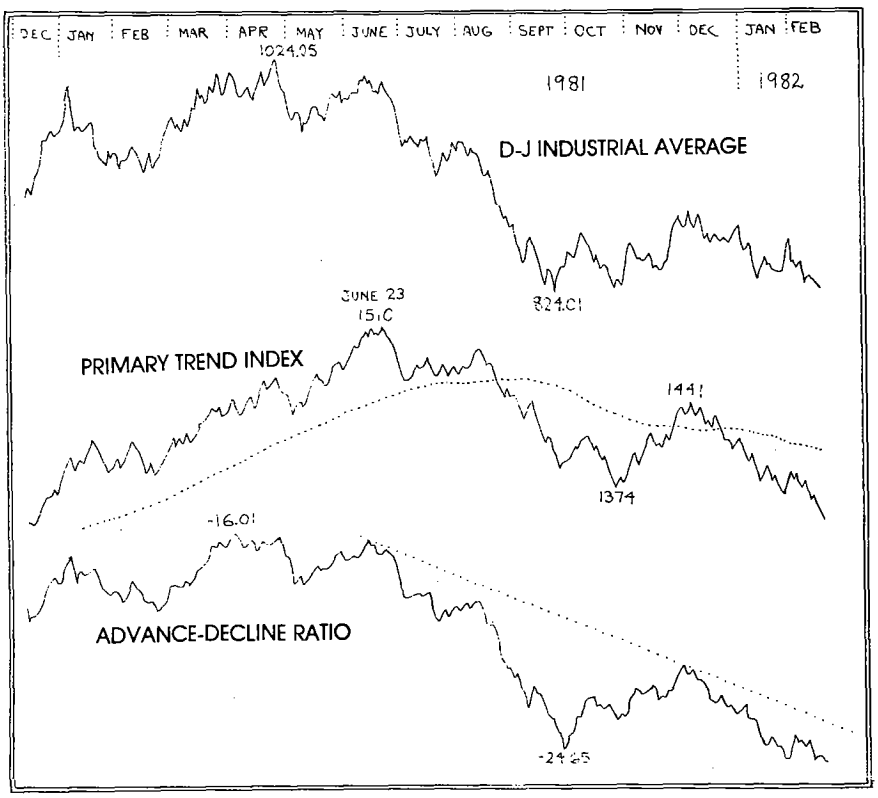
FRONT PAGE COMMENT: Ever since World War 11, the politicians have been buying votes via the various Federal entitlement programs. They've financed all these extravagant programs by spending more than the Treasury could take in for almost every year of the past 40 years. This year, 1982, is a milestone year–it's the year when the total Federal deficit rose to over $1 trillion.

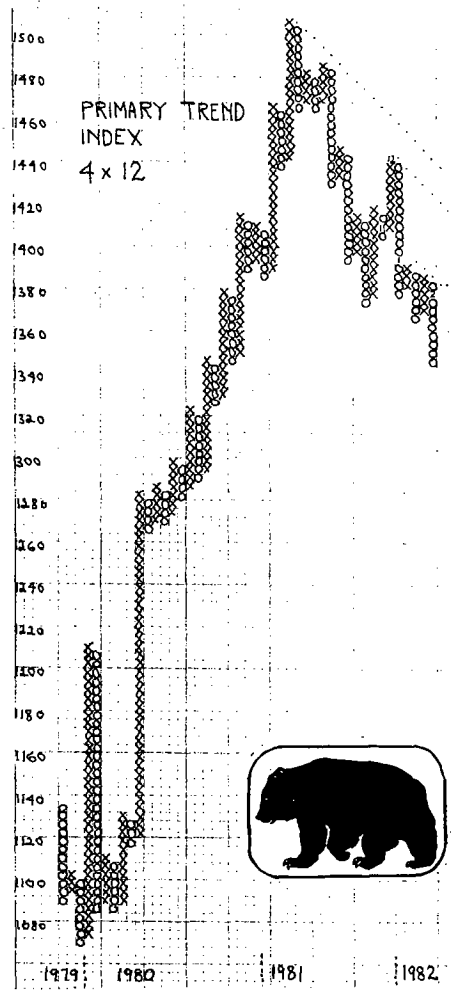
With new monster deficits in sight and three-quarters of the non-military budget supposedly "uncontrollable," interest rates have risen to the highest levels in modern history. What's happened is that the markets have revolted–they're scared as hell, and they're not going to take it any more!

You see, the politicians can bamboozle the public; they can blame inflation on the President, the gold-bugs, the fat cats, the big corporations. But they can't fool the markets. The markets are bigger than all the politicians that ever voted all the deficits this nation has ever had to suffer under. And today the markets are saying, "Enough." The markets are saying, "Keep running deficits and we'll put interest rates up so high that the nation will strangle in it's own profligacy!"

I love markets. They're all-powerful–and honest.







Meanwhile, I am appalled by the losses that traders have sustained in trying to outwit this market. Whipsaws, false move after false move, have cut traders to shreds. But still the urge to beat the market (at whatever cost, against whatever odds) seems to conquer common sense.

Despite the stand of the Averages above the September lows, the Primary Trend Index has been falling. On February 17 the PTI (see chart) sank to a bear market low of 1346. The PTI has been in a downward trend for the past eight months. So far it has lost 164 points or an average of 20 points per month. Compared to the violent decline of 1973-74, the slide in the PTI in 1981-82 appears to be one of attrition–a slow wearing down of the market.

Up to this point, the A-D ratio (which is a proxy for the whole NYSE) has pretty much followed the pattern of the PTI. So we have a divergent pattern: the A-D and the PTI have been leading on the downside–with the Averages so far resisting (holding above their September lows).

Ironically, since the public tends to watch only the Dow, few people are aware of the terrific losses that this bear market has inflicted on the nation. To illustrate, on June 23, 1981 (at the time of the PTI high) the value of the broad Wilshire Index of 5000 stocks was $1.404 trillion. As of last week the Wilshire was $1.184 trillion. This represents a loss of $220 billion in stock values or an average loss of $27 billion for each of the eight months since June! And that just includes stocks, it doesn't include bonds, housing, mortgages, commodities or collectibles.

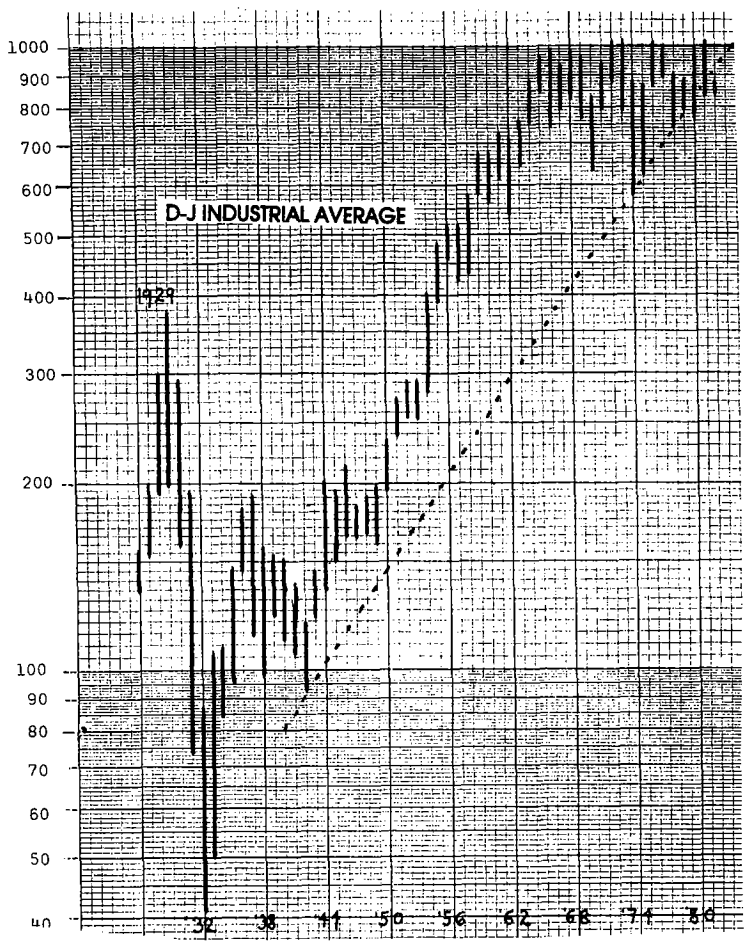
The point and figure chart of the PTI portrays a giant top pattern, with the most recent action being a plunge of 40 points in the PTI. Despite the ominous look of this pattern, 40 consecutive downside points in the PTI would seem to call for some (upside) corrective action. The market has, in fact, been trying to rise, but so far the rally can only be described as feeble–very feeble.

INVESTMENT POSITION: We're in a primary bear market. Unfortunately, one of the characteristics of a bear market is that "Whatever can go wrong–does go wrong." Thus, it will pay us to be very careful as this situation unwinds. Those who try to beat the bear through clever trading and premature bottom-picking will find (to their dismay) that the bear is shrewder than they are. The bear loves it when you match wits with him. He loves it because he knows you're building sandcastles against the tide–and the bear has the tide with him.

Basically, our security nest is 91-day Treasury bills. They continue to provide fat yields, and those of us who own them continue to sleep well. What more can you ask–in a bear market?

SPECIAL STUDY: This semi-logarithmic chart (page 3) shows the annual ranges for the D-J Industrial Average from 1926 to the present. Any long-term semi-log chart is important because such charts deal with RATE OF GROWTH or percentages of advance or decline. Thus, on a semi-log chart a rise from 50 to 100 takes up exactly the same vertical distance as an advance from 400 to 800. Both movements are actually 100% rises, and thus they show the same on a semi-log chart.

Here on this chart we can see why the crash of 1929-32 left scars on Americans that are felt to this day. The reason–the horrendous percentage drop in the Dow and most stocks. The drop was almost 90% or a smash from Dow 381 to Dow 41.



Following the unbelievable bear market low of 41 in 1932, the market roared up in a rebounding bull market to the 1937 high of 194. The Depression was still in effect, and the Dow then tumbled into a second severe bear market. The 1942 low for the Dow was 92. At the 92 low, the market seemed to have shaken off the worst of the great, speculative high of 1929 (Dow 381) as well as the crushing low of 1932 (Dow 41). At the 1942 low, the market was back at real value with a Dow price of 92 (which was still more than twice the value of the 1932 low).

From the 1942 low a tremendous period of growth follows. The growth in the Dow can be traced by a line drawn through the 1942 low of 92 and the 1974 low of 577. For 40 years or ever since 1942 the Dow has held above the trendline shown on this chart. During 1979 the Dow dipped temporarily below the trendline, but the year closed higher. In 1980 the Dow touched the trendline, but it closed higher.

The year 1981 is another story. Here for the first time we see the Dow holding decisively below its 40 year rising growth line. It would require a Dow rally above 900 to put the Average back above the trendline again.

What can we deduce from this chart? To me the story is clear. Following 1966 something "changed" in the Dow, and the Average moved sideways. Periodic secondary bull and bear markets whipped the Dow back and forth, but the 1000 level stood as an almost impenetrable barrier. Nevertheless, the Dow did have enough rallying power to hold persistently above its long rising trendline.

In 1981, for the first time, the trendline failed to hold. To me, this is an omen. It's the market's way of telling us that the tide is beginning to turn. No man alive can understand the full meaning of this action. But no investor in his right mind can afford to ignore it.

THE SECRET: According to an ancient Chinese proverb, a student went to a wise man and asked, "Is there any answer that will fit all situations?" The wise man pondered, and then said, "Yes, there is one answer." "What is it, sir?" asked the student. The wise man answered, "This too shall pass away."

By the same token, I've developed a modern parable that I believe will fit all situations. What is it, you ask. It's "Nothing's easy." I find myself murmering those mysterious words perhaps ten times every day.

A few weeks ago I noticed that many of my smartest and most successful friends in this business issued very bullish reports, telegrams, special wires to the effect that the market was in a great buying range and that a monster rally was in the offing. Most excitedly recommended that their subscribers move to a 100% common stock position. Then the market weakened, and the advisors ordered a move to cash. A new firming tone came into the market, and once more the advisors said, "load up with stocks."

What we see here is an old story on Wall Street. It's known as the "multiple whipsaw" or the "fleecing of the innocent." And what customers have discovered is that if you make three trades in the market, and each move entails only a 10% loss–then you have sustained an overall loss of about one-third of your capital. So much for in-and-out trading in a bear market.

Thus, "nothing's easy." There's always a new item in the Wall Street Puzzle, and because of those new items some of the most trusted trading formulas often run into stone walls. What can the new item be in 1982? In my opinion, it's the money market. Never in American history have investors had to deal with the kind of money situation we have now.

Budget Deficit Projections
(In billions of dollars)

	Fiscal Years Ending 9/30/82
Reagan Budget	$98.6
Lawrence Chimerine Chase Econometrics	108
Kathleen Cooper Security Pacific	95-100
James Fralick Morgan Guaranty	105-115
Alan Greenspan Townsend-Greenspan	98
David Jones Aubrey G. Lanston	95-100
Irwin Kellner Manufacturers Hanover	105
Alan Lerner Bankers Trust	95
Don Maude Merrill Lynch	95-100
Allen Sinai Data Resources	107.2
Gary Shilling Shilling & Co.	95-105
Robert Sinche Bear Stearns	100-105
John Wilson Bank of America	100-120

"Russell," you object, "What's so different about today? We all know the story. We're facing a huge deficit of maybe $90 to 100 billion in fiscal 1982. And we face more big deficits in '83 and'84. But that news has been out for weeks. So what else is new?"

And that is all true, the deficit news is out. In fact, on February 10 the WSJ published the deficit projections of 12 leading economists. And their projections were all remarkably the SAME–a Federal deficit of $95 to $115 billion for fiscal 1982.

Now I'll let you in on a terrible secret. I've never believed any of our Presidents or any of our Treasury Secretaries or any of our Congresses when it comes to budgets or budget deficits. And I don't believe Regan or Stockman or Reagan for that matter. Furthermore, I'm not sure they believe themselves.

A month ago I talked to my good friend, Tom Holt (Holt Advisory, 290 Post Rd., West, Westport, CT 06880) about the

budget. I talked to Tom because I know he does a lot of work on flow of funds, and I know that he is very good at his work. Tom and I shared the same thoughts on the budget deficit. Our thoughts were that the deficits are "going out of sight."

The latest Holt Advisory came in last week. In his report Holt put forth his carefully documented budget scenario for 1982. Here it is in capsule form: "With total expenditures climbing to $760 billion and receipts tailing off to $570 billion, the budget deficit for fiscal 1982 will thus approach $190 billion. Since the economy will not have recovered much in the December quarter, if at all, the Treasury will probably have to raise nearly $200 billion in calendar 1982. . . . No matter what the Treasury does, we therefore submit, a monumental credit squeeze is unavoidable."

This is in line with my own thoughts, and it may explain why the stock market is so resistant to rally. The fact is that what Holt suspects and what I suspect, other analysts and investors also suspect. These people don't take out advertisements in the New York Times. They don't announce it on prime-time TV. They don't send telegrams to their Congressmen. What do they do then? They sell every rally in the stock market.

MONEY: Well, Henry Kaufman, Salomon Bros. head economist agrees with me regarding where we put our money during much of 1981 and 1982. The T-bill reigned supreme with an average yield of 15% (and this free of state taxes). But what of the rest of 1982. So far, the ship stays on the same course, and I'm continuing to recommend that subscribers buy 91-day T-bills and "roll 'em over" into new 91-day denominations as the current bills come due.

> NEW YORK (UPI) — Investors in the bond market had a negative return in 1981 and wide swings in interest rates are likely to contribute to continued volatility in 1982, according to Henry Kaufman, chief economist at Salomon Bros.
>
> Money market instruments kept well ahead of inflation in 1981 for the second consecutive year, Kaufman wrote in a Salomon study of relative values in the bond market.
>
> "The simple strategy of rolling three-month Treasury bills — insulated completely from principal fluctuations — returned a stunning 15 percent before inflation," Kaufman said.
>
> The total return for 1981 on corporate bonds, as measured by Salomon's long-term, high-grade corporate bond index, by contrast was zero, the report showed.
>
> After adjusting for a 1981 inflation rate of roughly 9 percent, three-month T-bills gave a real return of about 6 percent, Kaufman said. The bond investor, after the same adjustment, suffered a 9 percent decline on investment.

I don't know how many of my subscribers fully comprehend the meaning of the current bond yield situation (and the resultant severe pressure on common stocks). Maybe this thought process will help. You own a pension fund. You buy long-term Treasury bonds at 14.5% yield. In THREE YEARS you have almost half your investment back at 14.5% yield. Now let's say the bonds drop 15% in price. Then average yields on the bonds (at market price) rise to about 17%. You buy more bonds and average out. The new 17% yields make bonds almost irresistible, and you continue to buy, knowing that the bonds are top quality and that they will pay off at maturity.

Where is the risk? For that we turn to politics. Reagan has stated that he will not alter his tax cuts, nor will he not cut the military budget. He's saying to Congress, "If you think the deficit is too high, cut the entitlements and reduce the deficits." He is saying, "Put up or shut up." With an election year upon us, it is rather doubtful whether Congress will make any really meaningful cuts.

Taking all this into consideration, Kaufman of Salomon Bros. estimates a crushing deficit of $138 to $148 billion in the current fiscal year. Kaufman estimates that the Treasury will borrow $39 billion in the first quarter, "an unusually high" $15 billion in the second quarter, $35 billion in the third quarter and a record $47 billion in the fourth quarter. That kind of borrowing is hardly going to help the bond market, and interest rates will stay high (or go higher).

But the chances are fairly good that the deficit situation could climax this year (or next). Thus, somewhere during 1982 or 1983 we might witness a major buying area for bonds. In other words, we could conceivably witness a final climax on the downside in the bond market–prior to a serious emergency move to Congressional budget-cutting, a move that will finally bring down the deficits. The ideal place to buy bonds would be during that emergency period in which the deficits go wild–and force the attention of Congress.

So as I see it, the risk in buying today's long-term, high yielding bonds is the risk of a final climactic washout that sends bonds to new panic lows. "But," you ask, "but suppose that washout doesn't come?" My answer is that it may not come, and that is the argument for at least beginning to accumulate high-quality bonds now.

How do I feel about actually moving on bonds? I feel that one can put about 10% to 15% of one's assets into long-term Treasuries here, with the stipulation that buying be stepped up sharply in the event of a panic later in the year (brought on, most likely, by worse than expected budget deficits or even a pick-up in business).

"Russell," you ask, "How can we have a pick-up in business if any improvement brings on higher interest rates? My answer: "That's exactly why you aren't going to see good times for a while–not until some of today's massive debt is liquidated."

What of current interest rates? My 13-day momentum on the T-bills is sinking now, and this suggests (in view of the steep recent rise in rates) that a correction is upon us. The correction should bring rates down a bit. But if you're waiting for a collapse in interest rates–I don't see it. What I do see is a see-saw year with rates staying generally high–and maybe a climax peak in rates as the true (enormous) size of the Federal deficit is perceived.

NOTES & QUOTES: With the cut-back in Federal funds to the states, I predicted that the states will try to make up the short-fall through issuance of (municipal) bonds. The flood has already started. In fourth quarter 1981 new bond issues totaled almost $13 billion, 25% above the year before. In 1982 Manufacturers Hanover believes new state bond issues could rise to a record $50 billion.

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Out here in the California badlands, citizens don't want to give up their handguns or any other kind of guns. The City Council in Alhambra, California tried to put a measure on the ballot for a statewide initiative on handgun control. There was such a storm of protest in the council chambers that the place had to be cleared before a vote could be taken. Result–better luck next time.

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A gasoline war in the Modesto area brought the price of unleaded regular down to $1.059 per gallon, and some station operators said the battle could drive the price below $1 soon. Two independent service station organizations—Gasco and Beacon—were engaged in the price cutting, and the war seemed to be spreading with the price for regular dropping to $1.079 in nearby Turlock.

Oil follow-up: The world is now producing a surplus of 2-3 million barrels of oil per day. OPEC and the major oil producers are now afraid that the oil price structure will collapse. Companies and purchasing agents are letting their huge oil tanks run dry—hoping to keep the market brimming with surplus (and, in the process, saving money on oil storage). Another thing that worries oil producers, aside from pumping out surpluses daily, is that countries like Iran, Iraq, Kuwait and the North Africans are itching to raise production. At best, it could be well into 1983 before the surplus is used up. And by that time, the recession could be having a dismal affect on oil consumption.

The implications of a weak oil price are far reaching. For the past few years oil companies accounted for MOST of the growth in the US. Of the $19.6 billion increase in profits posted by the 500 largest US companies between 1978 and 1980, $19.2 or 98% went to energy-related firms. If you make adjustments for inflation, the non-energy companies showed a sharp decline in real profits.

* *

Growth: You want to know what real "growth" looks like. Below are the five major entitlement programs in the US. The 1981 and 1982 comparisons are shown along with the percentage of increase over a single year. The five are Social Security, Medicare, Civil Service Retirement and Disability, Retired Military Pay and Supplemental Security Income. The increase in these five programs....$27.2 billion in a year.

	1981	1982	Pct. Inc.
SS	138.2	154.5	11.8
Med.	41.6	48.1	15.6
CSR	17.4	19.4	11.5
RMP	13.7	15.2	10.9
SSI	7.3	8.2	12.3
Totals	218.2	245.4	

* *

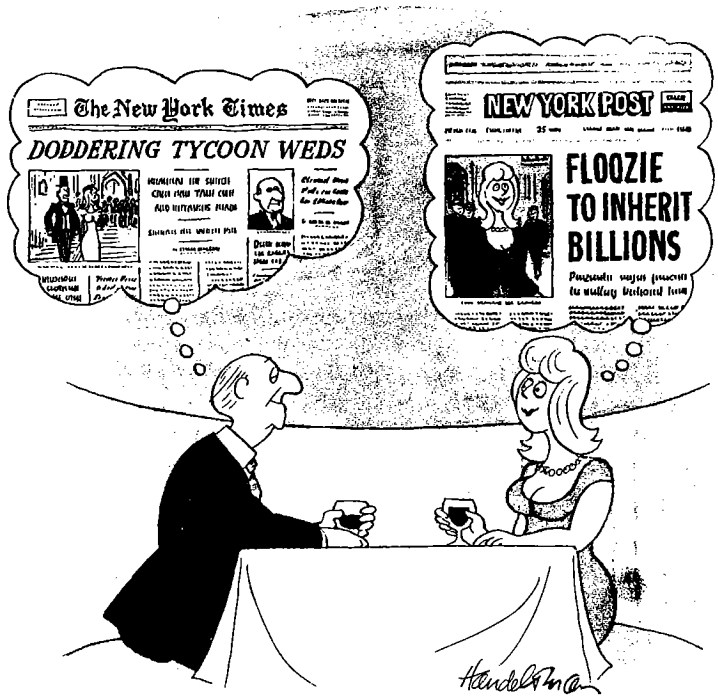
A lot of Mr. Reagan's own Republican cohorts are queasy about the coming deficits. The cartoonists have zero'd in on the situation, as witness this one from the ultra-conservative San Diego Union.....

* *

"Now It Can Be Told" Dept: The General Motors horror story emerges. It's the story of exploding debt, shrinking working capital, runaway capital spending. In the final three months of 1981 GM took on more than $1.4 billion in long-term debt, bringing GM's long-term debt to a record $3.8 billion, double the amount owed a year earlier. GM's interest costs have now risen to a whopping $1 billion a year. What do you call it when a company borrows its head off and continues to pay out the dividends. I call it insanity!

* *

People often write to ask me how analysts, using a lot of the same data and charts, can come to opposite conclusions about the stock market. Listen, we're not the only ones. Take the gentlemen and the girl below. How's that for two sides of the same coin! (Cartoon courtesy of the NEW YORKER)



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When gold started down the trade had to come up with a new item. The new item was the so-called "strategic metals." Ah, Wall Street, have you no mercy! Thousands of speculators took their losses in gold and then switched to strategic metals. Here's a rundown on what happened (tabulation courtesy of Johnannesburg Gold and Metal Advisor, P.O. Box 11634, Birmingham, AL. 35202).

Metal	Price Jan. 5, 1981	Price Dec. 29, 1981	% Change
Antimony	$3170/ton	$2495/ton	-21.3
Cadmium	$1.75/lb	$1.10/lb	-37.1
Chromium (metal)	$9920/ton	$7325/ton	-26.2
Cobalt	$25 /lb	$12 /lb	-52.0
Indium	$10.75/oz	$5.90/oz	-73.0
Iridium	$600 /oz	$600 /oz	—
Manganese (metal)	$1625/ton	$1455/ton	-10.5
Molyledenum (metal)	$27 /lb	$21.50/lb	-20.4
Platinum	$475 /oz	$475 /oz	—
Palladium	$200 /oz	$125 /oz	-37.5
Rhodium	$700 /oz	$600 /oz	-14.3
Rutherium	$45 /oz	$45 /oz	—
Tantalum (oxide)	$110 /lb	$38 /lb	-65.4
Titanium (sponge)	$8850/ton	$8850/ton	—
Tungsten	$13 /lb	$10.81/lb	-16.8
Vanadium (rentoxide)	$3.14/lb	$3.14/lb	—

* *

Excellence: I just purchased my 19th album in the great Time-Life series, "Giants of Jazz." I grew up with jazz. Back in the 1939-42 period I used to spend ALL my time listening to the fabulous jazzmen of 52nd Street, Harlem, the Savoy Ballroom and the fabled Minton's (jam sessions starting at midnight and lasting till dawn). At any rate, the albums put out by Time-Life are, as far as I'm concerned, a gift to music lovers. Each album deals with a different musician from Louis Armstrong to Duke Ellington to Fats Waller. My thanks to Time-Life.

Excellence 2: Last week I stopped in at a local Yamaha motorcycle dealer. I've always had a passion for cycles, and I rode BMW's for 15 years (in fact, the first thing I did when I came to California in 1961 was buy a motorcycle). But what I saw at Yamaha blew my mind. Talk about space age technology, talk about state-of-the-art mechanics and designing! The cycles were just fabulous–beautifully designed, great instrumentation, fabulous finish, spectacular fabrication. Anyone who is skeptical of Japanese manufacturing (and I haven't even seen the new Honda's Suzuki's or Kawasaki's) should drop in on a Japanese motorcycle dealership and examine the merchandise. Well, I came out without buying a cycle– but I was sorely tempted, and I still may do it.

GOLD: So far, the moving average studies have kept us out of trouble on gold. The 5-week MA for gold broke below the 13-week MA back in October, 1980. That was a first warning signal. Then in January, 1981, the 13-week MA broke below the 50-week (primary) MA. That was a most definite sell signal. Since then the 13-week MA has been consistently BELOW the 50-week MA. And except for a three-week spurt the 5-week MA has held consistently below the 13-week MA. The latest figures show the 50-week MA for gold at 436, the 13-week MA at 390 and the 5-week MA at 378. As long as those relationships hold, we have to stay away from gold.

Last week Gold broke to a new low fix of 367.50 (Feb. 18). Bulls on gold called to tell me that platinum, silver and palladium failed to confirm gold on the downside. Impressive, but I'm still staying out.

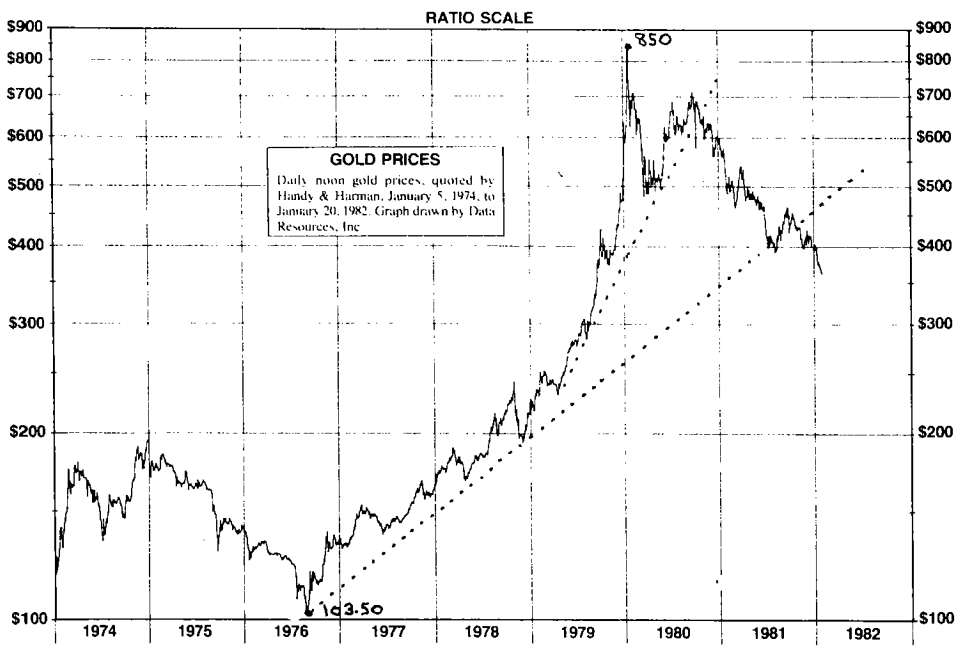
This beautiful semi-log chart is courtesy of my old friend, Harry Browne (Browne Special Reports, P.O. Box 5586, Austin, TX 78763). What we see here is a break of the rising trendline connecting the 1976 and 1978 lows. On a semi-log chart, a trendline represents a rate-of-growth based on percentages. So what the chart tells us is that gold's rate of growth, a rate that held steady from 1976 to 1980, is now broken. Now we have a rate of decline in gold. This is a deflationary indication and as I've said before, those who have been praying for deflation may find that they don't like it any better than inflation.

What's our protection against deflation? Money; it's as simple as that.

Oh yes, people ask me what I think of the Gold Commission's recent recommendation of a new US gold coin (it would not be legal tender). I don't think much of the idea, but it represents the Commission's effort to come up with something–anything. The coin represents about the very least the members could conjur up–short of denouncing gold as just another right wing plot.

LATE NOTES: February 19 closed with the A-D down for the 10th week of the last 11. After the close it was announced that M-1 was down $3 billion (presumably, what the market was waiting for). With this kind of over-sold situation in breadth, with the money supply down, with interest rates easing somewhat, the pressure is again on the bulls. If the market can't mount some kind of a rally here, then we're seeing a weaker picture than even the bears think possible.

The Dow again tested the September low of 824.01, but even if the Dow does crack through that low, Transports must confirm (by dropping under 335.48–the Sept. Transport low).



As the week closed (Feb. 19) the following are added to my diary: New 1982 lows recorded in the D-J 65 Stock Average and in the S&P 500. The A-D ratio (NYSE) sank to a new 6 year low. The Dow A-D dropped to a new bear market low of 63. Negative volume index to a new low. And gold (on the futures market) broke to a new low. Hardly a happy performance all around. Keep your eyes on the September lows in the Averages. Those lows will tell the story from here on.

Final thought: I've just updated my P&F chart of the broad NYSE Composite Index–and I've got to say that if this market holds together (barring a minor rally) it will be a miracle. The chart looks terrible.

NEXT MAILING: March 10